Supreme Court, U. S.
FILED
NOV 11 1976
MICHAEL RODAK, JR., CLERK

IN THE

Supreme Court of the United States

October Term, 1976.

No. 76-550.

MERRILL LYNCH, PIERCE, FENNER & SMITH, INC.,
Petitioner,

v.

PERCY D. AYRES,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Third Circuit.

RESPONDENT'S BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI.

DAVID L. GROVE,
Three Parkway, 20th Floor,
Philadelphia, Pennsylvania. 19102
(215) LO 3-0650
Attorney for Respondent, Percy D. Ayres.

Of Counsel:
FRANK S. DEMING,
MONTGOMERY, MCCRACKEN, WALKER & RHOADS.

International Printing Co., 711 So. 50th St., Phila., Pa. 19143 — Tel. (215) 727-8711

TABLE OF CONTENTS.

	Page
COUNTER-STATEMENT OF QUESTIONS PRESENTED FOR REVIEW ..	1
COUNTER-STATEMENT OF THE CASE	2
REASONS FOR NOT GRANTING THE WRIT	5
This Court Should Not Entertain Matters Presented by Interlocutory Petition Which Proceedings in the District Court and the Court of Appeals Hereafter Might Render Moot, and Which Are of Limited Effect in Any Event	5
The Court of Appeals Decided Correctly the Issues Which Were Presented to It	6
CONCLUSION	12
APPENDIX A—Amendment to Complaint	1A

TABLE OF CASES, STATUTES, RULES AND OTHER AUTHORITIES RELIED UPON.

Cases: Page

Alexander v. Gardner-Denver Co., 415 U. S. 36, 94 S. Ct. 1011, 39 L. Ed. 2d 147 (1974) 7, 9
Axelrod & Co. v. Kordich, Victor & Neufeld, 451 F. 2d 838 (2d Cir. 1971) 10, 11
Bernhardt v. Polygraphic Co. of America, 350 U. S. 198, 76 S. Ct. 273, 100 L. Ed. 199 (1956) 9
Brown v. Gilligan, Will & Co., 287 F. Supp. 766 (S. D. N. Y. 1968) 10
Dickstein v. duPont, 443 F. 2d 783 (1st Cir. 1971) 6
Isaacson v. Hayden, Stone, Inc., 319 F. Supp. 929 (S. D. N. Y. 1970) 6
Merrill Lynch, Pierce, Fenner & Smith v. Ware, 414 U. S. 117, 94 S. Ct. 383, 38 L. Ed. 2d 348 (1973) 7, 8
Moritz v. Francis I. duPont & Co., 291 Minn. 523, 189 N. W. 2d 487 (1971) 6
Newman v. Shearson, Hammill & Co., 383 F. Supp. 265 (W. D. Tex. 1974) 11
St. Louis Union Trust Co. v. Merrill Lynch, Pierce, Fenner & Smith, 412 F. Supp. 45 (E. D. Mo., E. D., 1976) 3, 4
Saxbe v. Bustos, 419 U. S. 65, 95 S. Ct. 272, 42 L. Ed. 2d 231 (1974) 11
Scherk v. Alberto-Culver Co., 417 U. S. 506, 94 S. Ct. 2449, 41 L. Ed. 2d 270 (1974) 9
Stokes v. Merrill Lynch, Pierce, Fenner & Smith, 523 F. 2d 433 (6th Cir. 1975) 6
United Steelworkers of America v. Warrior & Gulf Navigation Co., 363 U. S. 574, 80 S. Ct. 1347, 4 L. Ed. 2d 1409 (1960) 8
Wilko v. Swan, 346 U. S. 427, 74 S. Ct. 182, 98 L. Ed. 168 (1953) 8, 9

TABLE OF CASES, STATUTES, RULES AND OTHER AUTHORITIES RELIED UPON (Continued).

Statutes: Page

Securities Act of 1933:
Section 12(2), 15 U. S. C. § 771(2) 9
Section 14, 15 U. S. C. § 77n 8
Securities Exchange Act of 1934:
Section 3(a)(3), 15 U. S. C. § 78(c)(a)(3) 10, 11
Section 10(b), 15 U. S. C. § 78j(b) 4, 9
Section 28(b), 15 U. S. C. § 78bb(b) 6, 9, 10, 11
Section 29(a), 15 U. S. C. § 78cc(a) 6, 8
Securities Acts Amendments of 1975:
Section 21(1), 89 Stat. 160 10

Rules and Other Authorities:

Securities and Exchange Commission Rule 10b-5, 17 C. F. R. § 240.10b-5 4
New York Stock Exchange Rule 347(b), 2 CCH New York Stock Exchange Guide ¶ 2347 ..... 1, 6, 7, 8, 10, 11
H. R. Rep. No. 94-229, 94th Cong., 1st Sess., at 111 (1975) .. 9
U. S. Code Cong. & Admin. News 1975, p. 321 9

COUNTER-STATEMENT OF QUESTIONS PRESENTED FOR REVIEW.

1. Should this Court entertain matters presented by interlocutory petition which proceedings in the United States District Court for the Eastern District of Pennsylvania and the United States Court of Appeals for the Third Circuit hereafter might render moot, and which are of limited effect in any event?

2. Did not the Court of Appeals correctly determine that:

a. Rule 347(b) of the New York Stock Exchange ("Exchange") was not intended to cover claims under federal and state securities laws by a registered representative employed by an Exchange member that the member had defrauded the representative as a stockholder and seller of the member's stock to the member?

b. Even if Rule 347(b) were intended to govern such controversies, it would in any event be unenforceable and invalid as applied to this case?

COUNTER-STATEMENT OF THE CASE.

The pertinent facts of this case are summarized in the opinion of the Court of Appeals, as follows:

> "During a period from 1945-1970, plaintiff-appellant, Percy D. Ayres, was employed as a registered representative or "account executive" with the firm of Merrill Lynch, Pierce, Fenner & Smith, Inc., a well-known broker-dealer. Through various stock purchases and stock dividends, Ayres became the owner of 8,000 shares of Merrill Lynch common stock. In connection with his original and subsequent purchases, Ayres entered into agreements with Merrill Lynch which, *inter alia*, gave Merrill Lynch an option, exercisable for any reason on 90 days' notice, to repurchase all or any part of such stock held by Ayres. Merrill Lynch stock was not publicly owned during the period, and Ayres was permitted to own the stock solely because of his status as an employee.
>
> "The complaint alleged that, in the spring of 1970, Merrill Lynch began actively to explore the possibility of making a public offering of its stock. By July, the corporation's management had made an initial decision to go public and was taking preliminary steps towards accomplishing that goal. During the late summer, Ayres, who was ignorant of the planned offering which had not been publicly announced and who was under the impression that he would be permitted to retain his 8,000 shares of stock, advised Merrill Lynch of his intention to retire on October 1, 1970.[1]

1. Although Ayres had turned 65 in 1967, he had decided at that time to take advantage of Merrill Lynch's retirement policy under which he could remain in the firm's employ on a year-to-year basis until he attained the age of 70. Ayres retired at the age of 67, two days before his 68th birthday.

> "Advised by a fellow employee of the possibility that Merrill Lynch would exercise its 90-day options upon his retirement, Ayres approached a Merrill Lynch vice president to inquire about the firm's plans. The vice president told Ayres that he would take up the matter with the corporation's executives in New York and subsequently reported that Ayres would, in fact, be required to sell his stock if he chose to retire. Neither the vice president with whom Ayres spoke nor any other representative of Merrill Lynch informed Ayres of the prospective public offering. Unaware of the firm's plans, Ayres decided, on the basis of available information, to retire and thus to sell his 8,000 shares. Merrill Lynch subsequently purchased Ayres' stock for $209,064." (27a-29a)*

When Merrill Lynch went public some months thereafter, those shares, which in the interim were split 3 for 1, had a value of $672,000 (5a, ¶ 22).

Most of the factual allegations made by respondent against petitioner in this case have already been determined against petitioner in *St. Louis Union Trust Co., et al. v. Merrill Lynch, Pierce, Fenner & Smith, Inc., et al.*, 412 F. Supp. 45 (E. D. Mo., E. D., 1976).

In *St. Louis Union Trust Co.*, Chief Judge Meredith found that Merrill Lynch and certain of its officers and employees, in conscious disregard of plaintiffs' legal rights and owing plaintiffs a fiduciary duty, deliberately availed themselves of material inside information when Merrill Lynch repurchased its stock from plaintiffs prior to going public. In the circumstances Chief Judge Meredith found

* Page references to the appendices annexed to the petition are suffixed "a". Page references to the appendix annexed to this brief are suffixed "A".

that Merrill Lynch and the individual defendants violated section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act"), 15 U. S. C. 78j(b), and Securities and Exchange Commission Rule 10b-5, 17 C. F. R. § 240.10b-5; committed common law fraud; and breached their fiduciary duties.

St. Louis Union Trust Co. is presently on appeal to the United States Court of Appeals for the Eighth Circuit.

Respondent's detailed factual allegations appear in his Complaint (1a-9a) and in his Amendment to Complaint (1A), neither of which has been answered by petitioner. Petitioner did not include respondent's Amendment to Complaint in the appendices to the petition. It is annexed hereto at 1A.

Contrary to the assertion made in the footnote on page 7 of the petition, respondent's Complaint, as amended, alleges that petitioner wrongfully concealed material facts from respondent; that in repurchasing respondent's stock petitioner acted without any justifiable corporate purpose and for a fraudulent purpose; and that petitioner's conduct, as described in the Complaint, as amended, was malicious, willful and intentional.

REASONS FOR NOT GRANTING THE WRIT.

This Court Should Not Entertain Matters Presented by Interlocutory Petition Which Proceedings in the District Court and the Court of Appeals Hereafter Might Render Moot, and Which Are of Limited Effect in Any Event.

The Court of Appeals has remanded this case to the District Court for further proceedings consistent with the Court of Appeals' opinion. The District Court must now decide respondent's securities fraud claims on their merits. Respondent fully expects that the District Court will find for respondent and be upheld by the Court of Appeals. However, the District Court could conceivably hold against respondent and be sustained by the Court of Appeals. Alternatively, the District Court might find for respondent and be reversed by the Court of Appeals. There are thus many courses which this case might take hereafter, some of which would render unnecessary a decision by this Court in this case on the matters sought to be presented by petitioner at this time.

The decision of the Court of Appeals directly affects only respondent and petitioner. Conceivably, it might bear upon another case (i) arising in the Third Circuit, (ii) involving a registered representative employed by an Exchange member, (iii) who agreed to arbitrate only employment and termination of employment disputes, and (iv) who owned shares in the member, (v) which were not publicly traded, (vi) which were subject to a repurchase option, and (vii) which were repurchased by the member shortly before the member "went public", the member having fraudulently concealed its actual plans to do so from the representative. However, it has no broader application.

The Court of Appeals, having stated that it had ". . . no occasion to mark the bounds of Exchange Rule 347(b) . . . ," held only that the controversy between petitioner and respondent ". . . falls outside the perimeter of the rule." (31a-32a). Certainly that holding does not merit the attention of this Court on interlocutory petition.

The Court of Appeals Decided Correctly the Issues Which Were Presented to It.

Contrary to the contentions of petitioner, the Court of Appeals properly construed Exchange Rule 347(b); properly applied the non-waiver provision of the Exchange Act, section 29(a), 15 U. S. C. § 78cc(a); and properly interpreted the limited exemption from section 29(a) which is found in section 28(b) of the Exchange Act, 15 U. S. C. § 78bb(b). As the Court of Appeals held:

> "Although we find the question not free from doubt, we do not think that Exchange Rule 347(b) was intended to cover a controversy that has a causal connection to the fact of employment as remote as that involved in this dispute. All of the cases that have applied Exchange Rule 347(b) concerned the terms of the consensual relationship between registered representatives and Exchange members and the respective rights and duties of the parties as employer and employee.[1] While we have no occasion to mark the bounds of Exchange Rule 347(b), we believe the Rule was primarily designed to cover such disputes and that the present controversy falls outside the perimeter of the rule.

1. See *e.g., Stokes v. Merrill Lynch, Pierce, Fenner & Smith*, 523 F. 2d 433 (6th Cir. 1975); *Dickstein v. duPont*, 443 F. 2d 783 (1st Cir. 1971); *Isaacson v. Hayden, Stone, Inc.*, 319 F. Supp. 929 (S. D. N. Y. 1970); *Moritz v. Francis I. duPont & Co.*, 291 Minn. 523, 189 N. W. 2d 487 (1971).

"In our view, the dispute here has its primary genesis in an alleged securities fraud and concerns Ayres' right under federal and state securities laws as a stockholder and as a seller of securities. It does not center on Ayres' rights as a former employee under any consensual arrangement relating to the terms and conditions of his employment or termination. Although in a purely factual sense, the claims are connected with the termination of employment, the legal rights being asserted have a source wholly independent of the employment relationship. Arbitration is a matter of contract, and we do not think Ayres can reasonably be understood to have waived his right to judicial trial of such claims.

"The Supreme Court has characterized Exchange Rule 347(b) as relating to the 'exchange's housekeeping affairs' and has suggested it deals primarily with 'the area of wage claims.' *Merrill Lynch, Pierce, Fenner & Smith v. Ware*, 414 U. S. 117, 136, 94 S. Ct. 383, 38 L. Ed. 2d 348 (1973). To conclude that the Rule applied under the unusual circumstances of this case would be, in our view, to stretch the Rule well beyond those goals. Here the arbitrators would be called upon to apply legal precepts whose importance transcends the Exchange's interests in self-governance and to draw upon far more than the specialized knowledge of industry needs and practices that makes arbitration appropriate when the terms and conditions of the employment relationship are at issue. *Cf. Alexander v. Gardner-Denver Co.*, 415 U. S. 36, 56-57, 94 S. Ct. 1011, 39 L. Ed. 2d 147 (1974). Moreover, the Securities and Exchange Commission, which now has jurisdiction to amend, modify or repeal any Exchange rule, opposes any

construction which would make Exchange Rule 347(b) applicable under the circumstances of this case. See 15 U. S. C. § 78(b). Compare *Merrill Lynch, Pierce, Fenner & Smith v. Ware, supra,* 414 U. S. at 129-131, 94 S. Ct. 383. See page 538 below [37a-39a].

"Our conclusion that Exchange Rule 347(b) is inapplicable here is buttressed by the fact that even if Exchange Rule 347(b) was intended to govern controversies such as this, we believe it would, in any event, be unenforceable and invalid as applied to this case.[2] In *Wilko v. Swan,* 346 U. S. 427, 74 S. Ct. 182, 98 L. ed. 168 (1953), the Supreme Court held that the anti-waiver provision of the Securities Act of 1933, 15 U. S. C. § 77n, which is almost identical to § 29(a) of the 1934 Act, 15 U. S. C. § 78cc(a),[3] rendered 'void' a prospective agreement between a brokerage firm and a customer which would have required arbitration of the customer's claim under

2. The existence of countervailing federal policies, see *Wilko v. Swan, supra,* makes cases showing a hospitable attitude to the construction of arbitration clauses inapposite. For example, *United Steelworkers of America v. Warrior & Gulf Navigation Co.,* 363 U. S. 574, 80 S. Ct. 1347, 4 L. Ed. 2d 1409 (1960), on which Merrill Lynch principally relies, expressly terms "the run of arbitration cases, illustrated by *Wilko v. Swan* . . . irrelevant." Id. at 578, 80 S. Ct. at 1351.

3. Section 14 of the 1933 Act, 15 U. S. C. § 78n, provides:

> "Any condition, stipulation or provision binding any person acquiring any security to waive compliance with any provision of this subchapter or of the rules and regulations of the Commission shall be void."

Section 29(a) of the 1934 Act, 15 U. S. C. § 78cc(a), provides:

> "Any condition, stipulation, or provision binding any person to waive compliance with any provision of this chapter or of any rule or regulation thereunder, or of any rule of an exchange required thereby shall be void."

§ 12(2) of the 1933 Act. We need not review here the fundamental and important differences between litigation in a court and arbitration.[4] It is enough to say that the Supreme Court found prospective waivers of the right to judicial trial and review to be inconsistent with Congress' overriding concern for the protection of investors. *Wilko v. Swan, supra,* 346 U. S. at 437, 74 S. Ct. 182; see *Scherk v. Alberto-Culver Co.,* 417 U. S. 506, 512, 94 S. Ct. 2449, 41 L. Ed. 2d 270 (1974). As Merrill Lynch points out, a 'colorable argument can be made' that *Wilko v. Swan* should not apply to arbitration of judicially implied causes of action under the 1934 Act. We are not, however, persuaded that either the differences between the rights granted in the 1933 and 1934 Acts or any consideration of policy warrant such a distinction.[5] And we note that Congress appears to have accepted the view that *Wilko v. Swan* applies in the 10b-5 context. Cf. H. R. Rep. No. 94-229, 94th Cong., 1st Sess., at 111 (1975), U. S. Code Cong. and Admin. News 1975, p. 321.

• • •

4. See, *e.g. Alexander v. Gardner-Denver Co.,* 415 U. S. 36, 56-58, 94 S. Ct. 1011, 39 L. Ed. 2d 147 (1974); *Wilko v. Swan, supra,* 346 U. S. at 435-37, 74 S. Ct. 182; *Bernhardt v. Polygraphic Co. of America,* 350 U. S. 198, 203 & n. 4, 76 S. Ct. 273, 100 L. Ed. 199 (1956).

5. This "colorable argument" was mentioned, but not explored, in dicta in *Scherk v. Alberto-Culver Co., supra,* 417 U. S. at 513-14, 94 S. Ct. 2449, a 5-4 decision in which the Court accepted the premise that *Wilko v. Swan* was applicable. The Court noted that the 10b-5 cause of action is judicially implied, whereas § 12(2) expressly provides a private cause of action, and that the 1934 Act vests exclusive jurisdiction in the federal courts while the 1933 Act grants concurrent federal and state jurisdiction.

"Merrill Lynch also argues that § 28(b) of the Securities and Exchange Act exempts Exchange Rule 347(b) from the invalidating effect of the anti-waiver provision of the Act. As amended,[6] § 28(b) provides:

> 'Nothing in this title shall be construed to modify existing law with regard to the binding effect (1) on any member of or participant in any self-regulatory organization of any action taken by the authorities of such organization to settle disputes between its members or participants, . . . or (3) of any action described in paragraph (1) . . . on any person who has agreed to be bound thereby.'

"Merrill Lynch argues that § 28(b)(3) operates to preserve the "binding effect" on Ayres of Exchange Rule 347(b). In their view, promulgation of Exchange Rule 347(b) constituted the type of 'action' contemplated by the statute and Ayres is a 'person who has agreed to be bound thereby.'

"We agree with Merrill Lynch that the term 'action taken by the authorities . . . to settle disputes between members or participants' includes Exchange 'action' in prescribing compulsory arbitration rules and is not limited to the actions of Exchange arbitrators in settling pre-existing disputes. See *Axelrod & Co. v. Kordich, Victor & Neufeld*, 451 F. 2d 838, 841 (2d Cir. 1971); *Brown v. Gilligan, Will & Co.*, 287 F. Supp. 766, 774 & n. 18 (D. S. N. Y. 1968); 15 U. S. C. § 78c(a)(3)(26) (Supp. 1, 1976). But the mere fact that Ayres agreed to be bound by Exchange

6. Section 28(b) was amended by § 21(1) of the Securities Acts Amendments of 1975, 89 Stat. 160. Since the amendment does not affect the substance of the section in any way pertinent to this case, we have set out the section as it presently reads.

Rule 347(b) is not enough to bring that Rule within the exemptive provisions of § 28(b). Under the plain language of the statute, Exchange 'action . . . to settle disputes *between members or participants*' (emphasis added) is a prerequisite to application of § 28(b). Here that ingredient is missing. Exchange Rule 347(b) addresses controversies between registered representatives and member firms, not 'disputes between members or participants'. And it is undisputed that Ayres is not and has never been a 'member of or participant in any self-regulatory organization' for purposes of § 28(b).[7]

"Our construction of § 28(b) is mandated by the plain and unambiguous language of the statute. It is, as well, the interpretation suggested by the Securities and Exchange Commission, which has appeared in this case as amicus curiae. As the agency charged with the duty of administering the Securities Exchange Act and of supervising the stock exchanges' regulatory procedures, its view is to be given consideration. See, *e.g.*, *Saxbe v. Bustos*, 419 U. S. 65, 74, 95 S. Ct. 272, 42 L. Ed. 2d 231 (1974).

"The only case whose holding is arguably inconsistent with the view we have taken is *Axelrod & Co. v. Kordich, Victor & Neufeld*, 451 F. 2d 838 (2d Cir. 1971). But see *Newman v. Shearson, Hammill & Co.*, 383 F. Supp. 265 (W. D. Tex. 1974). But the court in *Axelrod* did not discuss the question of whether § 28(b) was limited to 'disputes between members' and decided the question *sub silentio*, without apparent recognition of the problem. Moreover, *Axelrod* is distinguishable on both factual and policy

7. See 15 U. S. C. § 78(a)(3)(A) (Supp. I 1976) (definition of member); 15 U. S. C. § 78c(a)(3)(24) (Supp. I 1976) (definition of participant).

grounds.[8] See *Newman v. Shearson, Hammill & Co., supra,* 383 F. Supp. at 268-69." (31a-39a).

8. Axelrod involved a dispute between a member and a non-member firm. The non-member had instituted arbitration proceedings under Article VII, § 1, of the NYSE Constitution after a contract dispute had arisen. The member firm attempted to avoid the binding effect of the Constitution by commencing a federal court action and seeking to rescind the contract because of alleged securities violations. Against that background the court stated at pp. 842-43 of 451 F. 2d:

> "[T]he policy considerations relied on by the Supreme Court in *Wilko* are inapposite here. The Supreme Court found that the non-waiver provision there involved was designed to protect investors. 346 U. S. at 431. Without such provision, financial houses might escape statutory liability by taking advantage of the inferior bargaining position of customers. But the legislative policy of protecting investors will not be thwarted by compelling an exchange member to arbitrate, at the instance of a non-member, a dispute which is arbitrable under the exchange's constitution."

These holdings by the Court of Appeals are well-reasoned and sound, and are clearly consistent with prior decisions of this Court.

CONCLUSION.

There is no good reason for this Court to involve itself in this case at this time. The petition for a writ of certiorari should be denied.

Respectfully submitted,

DAVID L. GROVE,
Three Parkway,
Philadelphia, Pennsylvania. 19102
(215) LO 3-0650
Attorney for Respondent.
Percy D. Ayres.

Of Counsel:
FRANK S. DEMING,
MONTGOMERY, MCCRACKEN,
WALKER & RHOADS.

IN THE
UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

—

CIVIL ACTION NO. 71-2986.
JURY TRIAL DEMANDED.

—

PERCY D. AYRES
370 Sycamore Avenue
Merion, Pennsylvania 19066,

Plaintiff,

v.

MERRILL LYNCH, PIERCE, FENNER & SMITH, INC.
70 Pine Street
New York, New York,

Defendant.

AMENDMENT TO COMPLAINT.

Plaintiff, Percy D. Ayres, hereby amends his Complaint in the above action by adding thereto the following paragraphs:

"38. After July 14, 1970 the repurchase rights referred to in paragraphs 7 *et seq.* above were invalid and unenforceable, since they did not thereafter serve any valid, consistently adhered to, corporate purpose of defendant.

"39. Even if legal *per se* after July 14, 1970, defendant's exercise of those rights after that date constituted a violation of section 10(b) and Rule 10b-5, and common law fraud, since that exercise was without any justifiable corporate purpose and was for a fraudulent purpose.

"40. Defendant's conduct, as described above, was malicious, willful and intentional, and entitles plaintiff to exemplary and punitive damages."

and by adding thereto a demand for exemplary and punitive damages in an amount in excess of $625,000.00.

/s/ DAVID L. GROVE,
David L. Grove,
Three Parkway,
Philadelphia, Pennsylvania. 19102
Attorney for Plaintiff.

Of Counsel:
FRANK S. DEMING,
MONTGOMERY, MCCRACKEN,
WALKER & RHOADS.